

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RICHARD M. MUFFOLETTO	:	DETERMINATION
for Redetermination of a Deficiency or for	:	DTA NOS. 801567
Refund of Personal Income Tax under Article 22	:	AND 802284
of the Tax Law for the Years 1981 through 1983.	:	

Petitioner, Richard M. Muffoletto, Meadowspring Road, Glen Cove, New York 11542, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1981 through 1983.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on September 6, 1995 at 10:00 A.M., with all briefs to be submitted by March 4, 1996. Petitioner appearing by Lane and Mittendorf, LLP (Alan R. Wentzel, Esq., of counsel) submitted a brief on December 4, 1995. The Division of Taxation appearing by Steven U. Teitelbaum, Esq. (Vera R. Johnson, Esq., of counsel), submitted a brief on February 13, 1996. Petitioner's reply brief was submitted on February 22, 1996, which date commenced the six month period for issuance of this determination (Tax Law § 2010.3).

ISSUE

Whether petitioner was a person required to collect, truthfully account for and pay over withholding tax with respect to Mansfield Contracting Corporation and/or National Mansfield Corporation, who willfully failed to do so thus becoming liable for a penalty equal to such unpaid tax under section 685(g) of the Tax Law.

FINDINGS OF FACT

1. On July 30, 1984 the Division of Taxation ("Division") issued to petitioner, Richard M. Muffoletto, a Notice of Deficiency and a Statement of Deficiency asserting penalties in the

aggregate amount of \$268,387.49. The amount of penalty asserted represents the unpaid withholding tax on wages of employees of an entity known as Mansfield Contracting Corporation for the following periods:

<u>PERIOD</u>	<u>AMOUNT</u>
12/16/81 - 12/31/81	\$ 50.53
02/01/82 - 05/31/82	109,622.98
01/08/83 - 06/30/83	<u>158,713.98</u>
Total	<u>\$268,387.98</u>

2. On March 25, 1985, the Division issued to petitioner a Notice of Deficiency and a Statement of Deficiency asserting penalties in the aggregate amount of \$840,195.73. The amount of penalty asserted represents the unpaid withholding tax on wages of employees of an entity known as National Mansfield Corporation for the following periods:

<u>PERIOD</u>	<u>AMOUNT</u>
07/01/82 - 12/31/82	\$436,085.83
01/08/83 - 05/31/83	404,109.90
Total	<u>\$840,195.73</u>

3. Petitioner does not challenge the dollar amounts of the penalties set forth above, or the periods to which such amounts pertain. Furthermore, petitioner does not contest the \$50.53 penalty for the period 12/16/81 through 12/31/81, indicating the same to represent a minor (and inadvertent) underpayment for which he acknowledges responsibility. However, petitioner does contest the balance of the penalties asserted.

4. With respect to Mansfield Contracting Corporation and the period 02/01/82 through 05/31/82 petitioner argues, and the Division does not dispute, that the withholding tax amount (\$109,622.98), upon which the penalty against petitioner is based, has been paid. While not contesting that he was a person responsible to collect, account for and remit withholding tax for such period petitioner maintains, relying on Matter of Mark Phillips, Officer of ATI Video Enterprises, Inc., (Tax Appeals Tribunal, May 11, 1995), that the penalty should be cancelled because the tax has been paid. The Division in response argued at hearing that the tax was not timely paid for such period, and that petitioner thus remains liable for the penalty notwithstanding payment of the tax. The date of payment of the tax is not specified in the

record. However, payment was made prior to October 12, 1983, while the Notice of Deficiency was not issued to petitioner until July 30, 1984. The Division did not further address this issue in its brief. As to the balance of the penalties and periods in question, petitioner maintains that due to the intervention and acts of others, he was effectively precluded from paying the taxes and thus should be excused from liability premised on such nonpayment.

5. During all of the periods at issue herein, petitioner was the president and majority stockholder of a group of affiliated general and electrical contracting companies known collectively as the Mansfield Group ("Mansfield"). This group included the two entities noted above, Mansfield Contracting Corporation and National Mansfield Corporation.

6. Mansfield was engaged in public and private building construction, centered primarily around electrical contracting and the manufacture and installation of building automation and safety systems, including energy management systems, smoke and fire alarm systems, and the like. With the exception of work performed by technical employees servicing computer systems, and work performed by approximately ten electricians carrying out small office building tenant change contracts, Mansfield's work was covered by payment and performance bonds. These bonds covered more than 50 major contracts having a total contract value in excess of 69 million dollars. All but one of the bonds were issued by The Aetna Casualty and Surety Company ("Aetna"), with the exception being a bond issued by Insurance Company of North America ("INA") on a project for the New York State Dormitory Authority at Hunter College.

7. By late 1982, Mansfield had completed contract work valued at roughly 45 million dollars out of the 69 million dollar contract total. However, payments received as of such time amounted to only 39.8 million dollars. Thus, despite its projections that completion of all of the contracts would result in a surplus (profit) of approximately eight million dollars, the delay in receiving payments on completed work left Mansfield with a cash flow shortage in the third quarter of 1982. A loan of 1.6 million dollars from Chemical Bank, which had provided

previous financing on some of Mansfield's unbonded work, was not sufficient to cover petitioner's cash shortage.

8. In mid November 1982 Mansfield, through petitioner, approached Aetna and described the cash flow financial problem confronting Mansfield. Aetna's representative advised petitioner that Mansfield should prepare an analysis of its contracts and its financial situation for presentation to Aetna. In turn, a detailed analysis of Mansfield's contracts was prepared indicating that there were approximately 30 million dollars in payments to be received versus approximately 22 million dollars in costs to complete the contracts. Mansfield's analysis indicated a need for financing in an amount up to 3.5 million dollars to meet payroll expenses and vendor payables. Mansfield proposed to repay amounts advanced, after a six month standstill period, with interest over a five year term. Petitioner presented Mansfield's proposal to Aetna's representatives Eugene Ladd and Barbara Nimmich on December 7, 1982, explaining that state and federal withholding taxes and union benefits were due on jobs bonded by Aetna and that Mansfield needed funds to pay these items while it was awaiting payments under the contracts.

9. One week after its presentation to Aetna, and prior to Aetna's response, Mansfield ran out of money. Petitioner called Aetna in an attempt to obtain cash to meet Mansfield's December 16, 1982 payroll. Petitioner was referred to one Jerome Murray, a New York City attorney representing Aetna, who advised petitioner that if Aetna provided funding, all receipts on Aetna bonded jobs would belong to Aetna. Petitioner was also advised that any such contract payments received would not be allowed to be used for payment of taxes already due, notwithstanding that such receipts represented payments for work previously performed during periods and on jobs on which the tax liabilities had been incurred. Petitioner was advised by Mr. Murray that Aetna would advance funds to cover only net payroll, that is gross wages less payroll taxes and union benefits. This advice appears to be inconsistent with an Aetna proposal to Mansfield, made at a meeting two days earlier, in which Aetna indicated that it would pay all labor and associated tax and union costs on bonded jobs.

10. Aetna sent its accountants to Mansfield's offices to review Mansfield's books and records and determine how much money would be advanced, both to pay net payroll and to pay vendors. With respect to vendors, a determination was made by Aetna as to which were critical, non-critical and deferrable, and funds were advanced only for the vendors deemed critical. Mr. Murray dictated a letter, to be signed by petitioner on behalf of Mansfield, requesting the funds as determined above. This procedure continued through the end of December 1982, and Aetna's accountants reviewed every check issued by Mansfield to determine that the Aetna advanced money was being spent only in accordance with the procedure just outlined.

11. As part of the above procedures, Aetna required Mansfield to open a "joint control bank account" at the Bank of New York, into which account receipts from Aetna bonded jobs were to be deposited. During the initial stages, receipts on bonded jobs were accumulated in this account while Aetna considered its position. At this time Aetna, through Mr. Murray, wanted to know whether petitioner would be able to convince the IRS to allow additional time to pay past due withholding taxes. Petitioner was, on behalf of Mansfield, trying to work out a payment schedule with the IRS to permit Mansfield to continue operating. However, Aetna rejected a January 4, 1983 proposal made by petitioner which, contingent on reaching an appropriate payment schedule with the taxing authorities vis-a-vis past due taxes, would have seen Aetna advancing full ongoing payroll amounts, including taxes and union benefits, and allowing incoming contract receipts on bonded jobs to be used in meeting the past due tax payment schedule.

12. Notwithstanding the rejection of his proposal, petitioner continued to try to reach an agreement with the IRS regarding past due taxes. On January 11, 1983, petitioner met with IRS representative Anthony Venetz and reached an agreement whereby an immediate payment of approximately \$500,000.00 would satisfy past due federal taxes for all Mansfield companies except National Mansfield Corporation. With respect to National Mansfield Corporation, the agreement called for an initial payment of \$75,000.00, with twelve additional monthly installment payments of \$50,000.00 each starting February 1, 1983. Petitioner had invited

Aetna's representatives to attend this meeting, but they did not. However, Mr. Venetz telephoned Aetna's Eugene Ladd to obtain assurances that if Mansfield fell short in its monthly installments, Aetna would advance funds to meet such installments, noting that since Aetna controlled the receipts on bonded jobs (the bulk of Mansfield's work and receipts) Aetna's cooperation was necessary in order to assure fulfillment of the agreement. According to a memo by Mr. Venetz, he received the necessary assurances from Mr. Ladd. In addition, Mansfield notified Mr. Murray and other Aetna representatives of the terms of the agreement with the IRS.

13. Upon reaching this agreement, petitioner took all available funds in Mansfield's bank accounts, including all the funds in the joint control account, and paid them over to the IRS. This payment totalled slightly less than \$500,000.00 because Mansfield did not have the full amount available in cash.

14. In response to the foregoing agreement and payment to the IRS, Mr. Murray and Aetna's other representatives were angry that receipts from bonded jobs had been used in payment of past due taxes. Aetna demanded that the money paid be returned, repudiated Mr. Ladd's assurance of support for the monthly payments, and demanded that the joint control account be changed such that checks could be drawn on such account only with the presence of Aetna's signature thereon (either alone or in addition to petitioner's signature).

15. At this point in time (mid-January 1983), petitioner accused Aetna of destroying his business because of Aetna's refusal to pay vendors for materials to be delivered to job sites, its refusal to sign a long-term agreement for funding to establish stability, and its insistence (through Mr. Murray) upon not funding the agreement with the IRS so as to pay off back taxes. By a letter dated January 17, 1983, petitioner advised Aetna that he intended to close down Mansfield's operations effective January 19, 1983. Petitioner listed all union benefits and taxes which were due on Aetna bonded projects for the net payrolls previously financed by Aetna. In this regard, evidence in the record indicates that Aetna representatives did not dispute the obligation to apply receipts on the bonded projects to tax liability (said funds being subject to a

trust for the payment of, inter alia, taxes), at least for those payrolls which had been financed (as net payrolls) by Aetna. It also appears that miscommunication among Aetna's representatives may have led to a situation where one of such representatives believed that an escrow account for the payment of taxes on Aetna funded payrolls had been established when in fact no such account had been created or funded.

16. In response to petitioner's threat, Aetna representatives asked petitioner not to close down Mansfield's operations. Petitioner testified that Aetna completed the paperwork to require an Aetna signature on all checks drawn on the joint control account. However, the record does not contain any contemporaneous documentary evidence (bank resolutions or signature cards) showing that such paperwork was completed, at least not at any point prior to mid June of 1983. Aetna also began to limit future funding advances to the difference between net payrolls on bonded jobs versus receipts on bonded jobs. That is, Aetna's accountants would determine Mansfield's "needs" (i.e., net payroll, critical vendors, etc.), compare such amount to the amount of money in the joint control account, and Aetna would advance the difference or "shortfall" between such two amounts. Under this procedure, there were thus insufficient funds available to pay taxes. Petitioner noted that he was aware that Aetna had not paid the taxes due on payrolls funded by Aetna and that upon inquiry of Aetna's auditors regarding this issue petitioner was advised "[w]e haven't paid them yet. We're accumulating all of the information and we will pay them."

17. On or about January 20, 1983, having received no union benefit payments for over one month, the unions began to remove workers from Mansfield's job sites. In response, Aetna agreed to advance money for union benefits amounts. However, Aetna continued to advance Mansfield's payrolls net of taxes. Petitioner testified to his belief that Aetna was undertaking to file reports and pay weekly payroll withholding tax with its own checks. Aetna's representatives did not advise petitioner whether or not such tax payments were in fact made, and the record does not disclose whether, and to what extent, petitioner made additional inquiries on this issue. Between February and May of 1983, the letters dictated for petitioner's signature, by which

Mansfield requested funding advances, would list the amounts of advance requested by each project bond number. However, the amount advanced, in the aggregate, continued to consist of net payroll, union benefits and vendor payments.

18. In late June 1983, Mansfield and Aetna entered into a written agreement formalizing the procedure for Aetna's advances to Mansfield. This agreement reflected the steps allegedly in place as of mid-January 1983 following petitioner's act of paying all available funds to the IRS. Under this written agreement, an Aetna signature was required on all checks drawn on the joint control account, Aetna was authorized to unilaterally withdraw funds from the joint control account in reimbursement of its advances and expenses, Aetna held the right to determine which claims under the bonds to pay (including who, when and how much would be paid), and all Mansfield receipts on bonded jobs were assigned to Aetna with Aetna authorized to endorse any such payment checks. Finally, the agreement provided for Aetna to pay over to Mansfield an amount for "overhead", which Mansfield planned to use for payment of the monthly installments to the IRS. While Aetna and Mansfield had some initial disputes about the amount of such "overhead" payments, all of the money received as "overhead" was paid over to the IRS.

19. INA, which bonded Mansfield's project for the Dormitory Authority, followed the same procedure as Aetna with regard to advancing only net payroll to the extent that such net payroll exceeded payments received on INA's bonded project, thus leaving no funds available to pay taxes on an ongoing basis.

20. The receipts from Mansfield's unbonded jobs were covered by a security agreement with Chemical Bank. Until April 1983, Mansfield retained control over these receipts and the same were used to pay taxes on such unbonded job payrolls. In April of 1983, after unsuccessful attempts to meet and reach agreement with Aetna, Chemical Bank called the Mansfield loans and began to exercise control over the unbonded job receipts. The unbonded job contracts were sold by the end of April 1983.

21. On May 17, 1983, Aetna and Chemical Bank entered into an agreement to divide any surplus on Mansfield contracts. Pursuant to this agreement, Chemical would receive nothing on contracts resulting in a loss. On any profitable contracts Chemical would split the surplus with Aetna in the ratio of 30 percent (Chemical Bank) and 70 percent (Aetna). Ultimately, Chemical Bank sued Aetna for breach of contract, claiming that Aetna charged expenses to Mansfield contracts in such a manner as to show losses on as many contracts as possible thereby minimizing any payments to Chemical under the agreement.

22. Aetna exercised its control over the joint control account, including removal of monies therefrom. On one occasion in July 1983, Mansfield had received some \$389,000.00 in payments and asked Aetna to apply the same to trust fund (i.e., tax) purposes. However, Mansfield later learned that the joint control account was empty, with Aetna having transferred the funds therein to a home office account. In response to Mansfield's request for assurance that the monies were being held for trust purposes, Aetna acknowledged its obligation to apply the funds to trust fund liabilities including taxes. However, Aetna did not advise petitioner whether or not the funds were used to pay taxes and, in fact, the funds were not so applied but rather were credited against Aetna's claim files. Petitioner continued to sign and file the forms reporting taxes due from Mansfield, and stated his belief that Aetna was paying the taxes and filing its own forms. However, petitioner did not have confirmation in this regard. Cover letters from Aetna to the IRS regarding payments do not reflect that either Mansfield or petitioner were copied on such payment letters.

23. Petitioner was advised by IRS agent Venetz during their meetings that it was customary, after an agreement had been reached on federal taxes, for Mr. Venetz to contact his counterpart at the Division to invite the Division to join and work together on a payout. Mr. Venetz advised that he would contact the Division and try to work out an installment agreement similar to the Mansfield/IRS agreement of January 11, 1983. The record does not disclose whether this contact in fact occurred. In any event, petitioner was not contacted by the Division

until warrants were served in October 1983, after which Division field activity did not occur until November 1983. Petitioner did not meet with Division personnel until January 1984.

24. In July 1983, Mansfield sent to Aetna copies of correspondence showing Mansfield's payment of taxes on unbonded jobs, and enclosing therewith checks drawn on the joint control account to be countersigned by Aetna for payment of taxes due on bonded jobs. In October 1983, the Division served warrants demanding payment of \$140,923.95 in withholding taxes. Mansfield in turn forwarded to Aetna and INA a calculation of the the amounts due on their respective bonded jobs. The taxes due on the nonbonded jobs totalled \$17,919.18, which amount was paid by Mansfield using funds belonging to another entity in the Mansfield Group (Westover Technology). Petitioner was not informed whether Aetna or INA paid the balance of taxes due on the bonded jobs.

25. Aetna's funding of "overhead" to Mansfield for payment of the monthly IRS installments ceased shortly after the June 1983 Aetna/Mansfield agreement was entered into, and Aetna demanded that petitioner "restore" the approximately \$500,000.00 taken from the joint control account in January to pay the federal tax amount. On November 4, 1983, Mansfield and Aetna executed a new agreement under which Mansfield was required to advise all of its contract holders to make all payments to Aetna in care of Mr. Murray. This agreement again required the establishment of a joint control account, and noted that Aetna was to have sole control over such account. This agreement remained in place until the IRS seized Mansfield's assets in early 1984.

26. In late 1983, when the IRS began to levy on Mansfield's bank accounts, Aetna removed the money from the joint control account and redeposited the same in its own accounts. In response, the IRS pursued Aetna and also served notices of deficiency personally on Ms. Nimmich, Mr. Ladd and Mr. Murray for their failures to pay Mansfield's withholding taxes. The IRS pursued its claim against Aetna until December 28, 1992, when it was settled for the payment of \$400,000.00.

CONCLUSIONS OF LAW

A. With regard to the withholding tax penalty asserted against petitioner, Tax Law § 685(g) provides:

"Willful failure to collect or pay over tax.--Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payments thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

Tax Law § 685(n), in turn, furnishes the following definition of "persons" subject to the section 685(g) penalty:

"[T]he term person includes an individual, corporation or partnership or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

B. The question of whether someone is a "person" under a duty to collect and pay over withholding taxes is a factual one, similar in scope and analysis to the question of whether one is a responsible individual for sales and use tax purposes. Factors which should be considered are, inter alia, whether the particular individual signed tax returns, derived a substantial part of his income from the corporation, or had the right to hire and fire employees (Matter of Malkin v. Tully, 65 AD2d 228, 412 NYS2d 186; see, Matter of MacLean v. State Tax Commn., 69 AD2d 951, 415 NYS2d 492, 494, affd 49 NY2d 920, 428 NYS2d 675). Other pertinent areas of inquiry include the person's official duties, the amount of corporation stock he owned, and his authority to pay corporate obligations (Matter of Amengual v. State Tax Commn., 95 AD2d 949, 464 NYS2d 272, 273; see, Matter of McHugh v. State Tax Commn., 70 AD2d 987, 417 NYS2d 799, 801).

C. Summarized in terms of a general proposition, the first issue to be resolved is whether petitioner had or could have had sufficient authority and control over the affairs of the corporation to be considered a person under a duty to collect and remit the unpaid taxes in question. In addition, and unlike the sales and use tax situation, if petitioner is held to be a person under a duty as described, it must then be decided whether his failure to withhold and

pay over such taxes was willful. The question of willfulness is related directly to the question of whether petitioner was a person under a duty, since clearly a person under a duty to collect and pay over the taxes is the one who can consciously and voluntarily decide not to do so. However, merely because one is determined to be a person under a duty, it does not automatically follow that a failure to withhold and pay over income taxes is "willful" within the meaning of that term as used in Tax Law § 685(g). As the Court of Appeals indicated in Matter of Levin v. Gallman (42 NY2d 32, 396 NYS2d 623), the test is:

"whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes No showing of intent to deprive the Government of its money is necessary but only something more than accidental non-payment is required" (*id.*, 396 NYS2d at 624-625; see, Matter of Lyon, Tax Appeals Tribunal, June 3, 1988).

The Tax Appeals Tribunal noted further, in Matter of Gallo, (Tax Appeals Tribunal, September 9, 1988):

"a responsible officer's failure can be willful, notwithstanding his lack of actual knowledge, if it is determined the officer recklessly disregarded his corporate responsibilities including the responsibility to see that taxes were paid" (Matter of Gallo, citing Matter of Capoccia v. New York State Tax Commn., 105 AD2d 528, 481 NYS2d 476; Matter of Ragonesi v. State Tax Commn., 88 AD2d 707, 451 NYS2d 301).

D. Dealing first with the issue of petitioner's liability for the period 2/1/82 through 5/31/82, the parties are in agreement, and the record bears out, that the underlying tax liability against Mansfield Contracting Corporation for such period (forming the basis for the dollar amount of penalty asserted against petitioner) has been paid. In Matter of Mark Phillips, Officer of ATI Video Enterprises, Inc., Tax Appeals Tribunal, May 11, 1995, the Division sought to collect, via responsible officer penalty notices under Tax Law § 685(g), penalties and interest asserted against the corporate entity ATI Video Enterprises, Inc. However, the Tribunal held that the Division is entitled to collect, under section 685(g), no more than the total tax due, and thus could not use officer assessments to collect penalties and interest due from the corporation. The Tribunal stated, relying on analogous Federal cases, that once the tax due has been satisfied, the Division is not entitled to further satisfaction from responsible officers.

Here, since it is conceded that the tax liability for the noted period has been satisfied, the Division may not collect the same again from petitioner. On this score, the Division advances no support, nor is any apparent, for the proposition that because the tax was paid late the Division is therefore entitled to collect a penalty equal to such tax from a corporate officer. Accordingly, the penalty asserted against petitioner as an officer of Mansfield Contracting Corporation for the period 2/1/82 through 5/31/82 is cancelled.

E. Turning to the remainder of the penalties and periods at issue, petitioner has acknowledged his responsibility for the inadvertent non-payment of \$50.53 for the period 12/16/81 through 12/31/81 (see, Findings of Fact "1" and "3"). Accordingly, such portion of the July 30, 1984 Notice of Deficiency is sustained. Thus, remaining in contest is the period 1/8/83 through 6/30/83 for Mansfield Contracting Corporation, and the periods 7/1/82 through 12/31/82 and 1/8/83 through 5/31/83 for National Mansfield Corporation. With respect to such periods, the Division maintains that petitioner retained control or, if not, that his delegation of control to Aetna was not reasonable, thus leaving petitioner responsible for the unpaid withholding taxes due for the noted periods. Petitioner argues, in contrast, that dire financial circumstances left him no viable alternative other than to seek financing assistance for Mansfield, and that in so doing he ultimately lost control over Mansfield and was unable to carry out the steps necessary to cause payment of the withholding taxes due from Mansfield. Petitioner maintains that he made every reasonable attempt to ensure that the withholding taxes were being paid on an ongoing basis and also made strong efforts to find a means to make payment of past due taxes. In sum, petitioner does not deny his position of responsibility with regard to Mansfield. Rather, petitioner maintains that Mansfield's financial circumstances in general, coupled with the acts of Aetna in particular, left him unable to carry out his responsibilities.

F. Contrary to petitioner's arguments, the evidence does not warrant excusing petitioner from responsibility for taxes due from Mansfield Contracting Corporation or National Mansfield Corporation for any of the periods remaining in issue. First, it is clear that petitioner

was in full control of Mansfield's operations and its finances during the period 7/1/82 through 12/31/82, and that taxes were not paid during such period. This nonpayment was apparently due to the described delay in Mansfield's receipt of payment for work already completed, coupled with an inability to secure short term outside financing. While petitioner had attempted to obtain financing to make payment on Mansfield's overdue bills, the fact remains that by the end of 1982 the taxes were unpaid and overdue and petitioner was still in control of Mansfield. Although by the end of 1982 Aetna had started to assert control over petitioner's receipts on bonded jobs, and had advanced net funding for the weekly payrolls starting on 12/16/82, petitioner had not lost authority and was not precluded from acting. Petitioner argues that since Aetna objected to petitioner's application of incoming receipts (earned on past performed work) in payment of prior period unpaid taxes, petitioner should be excused from liability for such past due taxes. This argument does not address or impact the reason for nonpayment of such taxes when due. While highlighting the financial predicament petitioner found Mansfield in, this circumstance does not relieve petitioner of liability based on prior period unpaid taxes.¹ In sum, petitioner remains liable for the penalty asserted for the period 7/1/82 through 12/31/82 based on the unpaid withholding taxes due from National Mansfield Corporation.

G. Although the overall circumstances of authority and control become less clear during the first six months of 1983, it appears that petitioner continued to be in a position of legal authority and control over Mansfield during such period. It is not disputed that an otherwise responsible person may be relieved of the obligation to pay over withholding taxes where a surety in fact takes over control of the company's funds and thus precludes such otherwise responsible person from paying (U.S. v. Falino, 441 F. Supp. 153, 78-1 USTC ¶ 9138). The key to such a result is, of course, establishing that the surety in fact took over control of the funds and, critically, establishing the point in time at which such control was taken away from the

¹While Aetna may also have come under a trust obligation to use such funds in satisfaction of past due taxes, the same does not relieve petitioner of his obligation to have paid such taxes when due. Thus, Aetna's failure to have applied incoming receipts to clear up past due taxes (i.e., for the period 7/1/82 through 12/31/82 for National Mansfield Corporation) does not overcome the fact that petitioner was in control of Mansfield and its receipts and disbursements during this period, or excuse petitioner from liability for the penalty asserted for such period.

otherwise responsible person. In Falino, the surety's control was clearly established by agreements dated prior to the tax periods at issue, and thus the failure of a responsible corporate officer to have used company funds to pay taxes due as required could not be held against such otherwise responsible person. In the matter at hand, the evidence bears out that Aetna at some point did in fact take over control of Mansfield's funds leaving petitioner, at such point, unable to carry out his responsibility. However, unlike Falino, the precise point in time when this occurred is not so clearly ascertainable.

H. Petitioner appears to argue that Aetna was in control of Mansfield's funds, and that petitioner had lost control over Mansfield and its funds, from the point in time when the first Mansfield payrolls were funded by Aetna, to wit, December 16, 1982. However, the evidence does not support this argument. On this score, to conclude that Aetna had taken over control as early as December 16, 1982 ignores the fact that petitioner still had the authority to negotiate an agreement with the IRS and to remove funds from the joint control account (without a countersignature from Aetna) in initial payment under such agreement in mid January 1983 (see Findings of Fact "12" and "13"). In the same vein, petitioner still had authority to shut down Mansfield's operations as born out by petitioner's letter of January 17, 1983 threatening such a shutdown on January 19, 1983 (see Finding of Fact "15").

In contrast, the parties executed an agreement dated June 21, 1983 by the terms of which it is apparent that Aetna did take over control of Mansfield's receipts and disbursements. Petitioner claims that such agreement merely formalized what was already in place. Thus, the question becomes whether the evidence bears out that such agreement and control had been in fact instituted at some point prior to June 21, 1983.

I. The evidence on the issue of Aetna's takeover is not fully supportive of petitioner's claim that Aetna was in control and that petitioner could not act prior to June 21, 1983. For example, the June 21, 1983 agreement calls for the establishment of a joint control account whereunder Aetna can unilaterally control disbursements and can limit any Mansfield disbursements by the requirement of an Aetna countersignature on any Mansfield drawn check.

Furthermore, while petitioner testified that Aetna changed the bank resolutions to institute this Aetna control shortly after the payment to the IRS in mid January 1983, there are no bank resolutions or signature cards in evidence, and the only documentary reference thereto is found in a letter dated November 15, 1983 stating that Mansfield was returning to Aetna executed corporate resolutions for the joint control account authorizing Aetna to act unilaterally with respect to such account. This letter notes that such resolutions were the same ones delivered to Mansfield earlier in the year (1983). In sum, the evidence leaves clear that Mansfield was in dire financial straits in terms of short term cash flow, and that its only apparent source of funding was through Aetna. Aetna, in turn, appears to have commenced funding while positioning itself for control. However, while Aetna was in a relative position of strength versus Mansfield, the evidence does not bear out that Mansfield and petitioner actually relinquished control to Aetna prior to the latter part of June 1983.

J. In addition to the foregoing, petitioner was aware that only net payrolls were being funded. In fact, petitioner was specifically advised by Aetna, through Mr. Murray, that Aetna would not be funding payroll taxes or union benefits (see Finding of Fact "9"). Aetna also rejected a later, January 4, 1983, Mansfield proposal under which Aetna would have funded payroll including taxes and union benefits (see Finding of Fact "11"). Petitioner listed unpaid taxes and union benefits on Aetna funded payrolls as part of his January 17, 1983 threatened shut down letter (see Finding of Fact "15"). Petitioner claims that he believed Aetna was filling out its own forms and paying the taxes, that he questioned Aetna's representatives on this point, and was advised that Aetna was accumulating information and that the taxes would be paid (see Finding of Fact "16"). Given this background, it is difficult to accept that petitioner reasonably believed the taxes were being paid. In light of the overall circumstances of petitioner and Mansfield's relationship with Aetna, petitioner's simple reliance on such advice is insufficient to excuse petitioner from responsibility, especially given that petitioner had been working with the IRS on the issue of unpaid withholding taxes. It would appear that a simple telephone inquiry to the IRS (or to the Division) would have been a reasonable step in order to confirm whether or

not taxes were being paid. In fact, the record is conspicuously short on references to any efforts to make sure that State withholding taxes were being paid on an ongoing basis. Nearly all of the references in correspondence during the first six months of 1983 were directed to the IRS and involved the payment of federal taxes. What emerges most clearly is that petitioner desperately needed cash to keep his companies alive and that he was, notwithstanding his threat of January 17, 1983, strongly against giving up and closing down Mansfield's business.

Petitioner chose not to close down Mansfield's business, but stayed on under the described circumstances of Aetna's funding which petitioner knew, or should reasonably have known, did not include the payment of taxes. While there is no indication that petitioner's legal authority over Mansfield was diminished at any given point, it is clear that he eventually did lose control over Mansfield's funds. Unfortunately, the evidence does not establish that petitioner was stripped of his authority, or had entered into an agreement under which he was precluded from affecting any actions, prior to late June 1983. Accordingly, petitioner was properly held responsible for penalties equal to the unpaid withholding taxes of Mansfield Contracting Corporation for the period 1/8/83 through 6/30/83 and of National Mansfield Corporation for the period 1/8/83 through 5/31/83.

K. The petition of Richard M. Muffoletto is granted to the extent indicated in Conclusion of Law "D" but is otherwise denied, the notice of deficiency dated July 30, 1984 is to be reduced accordingly and such notice as reduced, together with the notice of deficiency dated March 25, 1985, are sustained.

DATED: Troy, New York
August 1, 1996

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE